Supreme Court, U. S.
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IN THE SUPREME COURT

OF THE UNITED STATES

October Term, 1977

No. 76-1756

EMMETT E. NORTON and FRANCES G. NORTON,

Petitioners,

v.

THE UNITED STATES,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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I N T H E S U P R E M E C O U R T

OF THE UNITED STATES

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No. ____

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v.

THE UNITED STATES,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

Petitioners request that a writ of certiorari be issued to review the decision of the United States Court of Claims in the above-captioned case, which was entered on March 23, 1977.

OPINION BELOW

The opinion of the Court of Claims (App. A, *infra*, pp. A-1 to A-10) has not yet been officially reported. It is unofficially reported in 77-1 U.S. Tax Cases at ¶9296 and in 77 American Federal Tax Reports 2d at ¶77-499.

JURISDICTION

The opinion of the Court of Claims was entered on March 23, 1977. The order denying the petition for rehearing (App. B, *infra*, pp. B-1 to B-2) was entered April 29, 1977.

The statutory provision believed to confer on this Court jurisdiction to review the decision in question is Section 1255 of Title 28 of the United States Code.

QUESTIONS PRESENTED

In the light of this Court's 1955 declaration in *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, that:

> "Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than capital gain or loss. The preferential treatment provided by § 117 [the capital gains provision, now Section 1221 of the Internal Revenue Code] applies to transactions in property which are not the normal source of business income. It was intended 'to relieve the taxpayer from * * * excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions.' Burnet v. Harmel, 287 U.S. at page 106, 53 S.Ct. at page 75."

The questions presented here for review are:

1. Whether the principles enunciated by this Court in the *Corn Products* case should have been applied by the Court of Claims to a single sale in the final liquidation of the taxpayer's business.

2. Whether the *Corn Products* principle should be applied to the sale of an asset described in Section 1231 of the Internal Revenue Code.

STATUTES AND INTERNAL REVENUE REGULATIONS INVOLVED

The application of Sections 1221 and 1231 of the Internal Revenue Code are involved. The pertinent provisions of these statutes are set forth in Appendix C, *infra*, pp. C-1 to C-3.

STATEMENT OF THE CASE

1. Factual Background. This is a tax refund action, the facts of which are not in dispute. In January, 1968, petitioner Emmett E. Norton entered into a timber purchase contract with the Forest Service of the United States Department of Agriculture, by the terms of which he acquired the right to cut and ownership of certain designated timber in Alaska. During the year 1968 and continuing until March, 1969, Norton was engaged in the business of logging the timber and selling the logs produced therefrom. In March, 1969, Norton sold to Ketchikan Pulp

Company, an unrelated corporation, all of the timber and timber cutting rights acquired by him under the Forest Service contract for the sum of $127,500, payable as the timber was removed. During the years 1969, 1970 and 1971, Norton received the agreed purchase price from Ketchikan Pulp Company in payment for the timber and cutting rights.

In filing their joint federal income tax return for the year 1969, petitioners duly elected to report the sale on the installment basis pursuant to Section 453 of the Internal Revenue Code.

In January, 1973, petitioners were notified by the District Director of Internal Revenue in Anchorage, Alaska, of proposed income tax deficiencies against them for the years 1969, 1970 and 1971 aggregating $16,166, plus interest, based upon treating the proceeds as ordinary income rather than income from the sale of

a capital asset described in Section 1221 or from the sale of an asset described in Secton 1231 of the Internal Revenue Code. Thereafter, petitioners paid the income tax deficiencies, plus interest, filed timely refund claims and, when the refund claims were disallowed, filed this timely action in the Court of Claims in February, 1975. The basis for federal jurisdiction in the Court of Claims was Section 1491 of Title 28 of the United States Code.

2. Proceedings in the Court of Claims. The facts not being in dispute, in June, 1975, petitioners filed in the Court of Claims their Motion for Summary Judgment and in October, 1975, respondent filed its Cross Motion for Summary Judgment. The matter came on for oral argument before a three-judge panel of the Court of Claims on January 14, 1977 and on March 23, 1977 the Court rendered its opinion (Appendix A).

On April 4, 1977, petitioners filed a timely Petition for Rehearing En Banc, which was denied April 29, 1977 (Appendix B).

REASONS FOR GRANTING THE WRIT

The decision of the Court of Claims, in holding that the principle of *Corn Products* applies to a single sale of either a Section 1221 or Section 1231 asset, has decided a federal question in a way in conflict with applicable decisions of this Court. It also involves an important question of federal law which has not been, but should be, settled by this Court.

I

The Timber Sale Contract itself was a capital asset within the meaning of Section 1221 of the Internal Revenue Code.

If the Court finds that the contract itself (rather than the cutting rights or timber which was the subject of the

contract) was sold by Emmett E. Norton to Ketchikan Pulp Company, it should follow that a capital asset was sold.

By the statutory definition in Section 1221 of the Internal Revenue Code (Appendix C), the term "capital asset" includes all "property" held by a taxpayer, exclusive of five listed exceptions, none of which is apposite to this contract. The contract itself was not depreciable and was not real property, so the exception in Section 1221(2) would not be applicable. If it were, then Section 1231(b)(1) would control; but the tax result would be the same.

Since the decision in *Commissioner v. Ferrer*, (CCA 2, 1962) 304 F.2d 125, the courts have agreed that a contract is a capital asset, and its sale at a profit entitled to capital gains treatment, where the contract rights created an equitable interest in or an equitable encumbrance on

specific property which was itself a capital asset. Eustice, "Contract Rights, Capital Gain, and Assignment of Income--the Ferrer Case" (1964) 20 Tax L. Rev. 1, at 14.

Did the Timber Sale Contract here create in the vendee, Emmett E. Norton, an equitable interest in the timber? In interpreting a similar government timber sale contract, the Court of Claims in *Barclay v. United States*, (1964) 166 Ct. Cl. 421, 333 F.2d 847, stated:

> "Under this contract Dahl (one of the plaintiffs) did not acquire legal title to the timber on unallotted lands but he did acquire beneficial ownership of all timber on the tract . . ."

In addition to the five exceptions listed in Section 1221 defining "capital asset", there is, of course, the nonstatutory exception enunciated in *Corn Products Refining Co.* that profits and losses arising from the everyday operation

of a business should be given ordinary income tax treatment and that only transactions in property which are not the normal source of business income should give rise to capital gains or losses. By no stretch of the imagination can the routine, day-to-day sale of corn futures in the *Corn Products* case be equated with Emmett E. Norton's one isolated sale of a timber contract.

II

The timber which was the subject of the Timber Sale Contract was "real property used in the trade or business" of petitioner Emmett E. Norton, within the meaning of Section 1231(b)(1) of the Internal Revenue Code.

If the Court finds that the cutting rights or timber (as distinguished from the contract itself) was sold, it should follow that a Section 1231(b)(1) asset (Appendix C) was sold, since it would come

within the definition of "real property used in the trade or business" found in Section 1231(b)(1). In that event, the sale of such property rights would still be accorded capital asset treatment by virtue of Section 1231.

In *Corn Products* this Court dealt with a manufacturer of products made from corn, which entered into contracts to sell such products. In order to protect itself from sharp increases in the cost of its materials, it bought corn futures. In other words, it was engaged in hedging transactions. In one year it realized a substantial profit from the sale of the corn futures, and in other years suffered losses. In computing its tax liability, Corn Products originally reported these amounts as ordinary profit and loss from its manufacturing operations but subsequently took the position that the futures were capital assets and that gains and

losses therefrom should have been treated as arising from the sale of capital assets. The Tax Court found as a fact that the petitioner's futures transactions were an integral part of its business designed to protect its manufacturing operations against price increases in its principal raw material and to assure a ready supply for future manufacturing requirements.

This Court held:

> "Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than capital gain or loss. The preferential treatment provided by (the capital gains statute) applies to transactions in property which are not the normal source of business income. It was intended 'to relieve the taxpayer from . . . excessive tax burdens on gains resulting from a conversion of capital investments and to remove the deterrent effect of these burdens on such conversions.'"

Until the opinion in this case was issued, (Appendix A) neither the Court of Claims nor any other court had ever

applied the *Corn Products* principle to a single sale, whether or not in the final liquidation of a taxpayer's business.

By definition, a Section 1231 asset must be "used in the trade or business" of the taxpayer. If the decision of the Court of Claims is to be followed, the statute could have no application to any sale of a business asset and would, for all practical purposes, be repealed.

Petitioner's one sale in liquidation of the business can hardly be equated with the number of sales of corn future contracts (5,000 bushels each) by Corn Products Refining Co. which totaled 755, 535 and 728, respectively, in the three tax years involved there. *Corn Products Refining Co. v. Commissioner*, 16 T.C. 395, at 397.

The sale of the Turn Point contract was not a part of the everyday business of petitioner Emmett Norton. It

was the only one he ever made and terminated his business.

III

The opinion below did not respond to the issues as presented by the parties.

Petitioners and defendant agreed in their respective briefs filed in the lower court that petitioners' interest in the Turn Point contract and the underlying timber was real property used in the petitioners' trade or business within the purview of Section 1231 of the Internal Revenue Code. Despite this agreement of the opposing parties the opinion holds to the contrary. At the oral argument none of the three judge panel indicated at any time a disagreement with this basic factual premise and the oral arguments were, therefore, based upon an assumption that this issue was not in dispute. We submit that had the Court of Claims so expressed itself, the parties would have

addressed themselves to this issue and not assumed its acceptance.

Since the opposing parties agreed that the timber sale contract was "real property", the issues presented to the Court of Claims in the briefs and on the oral argument (in addition to petitioners' alternate Section 1221 argument) narrowed to the issue of whether or not the *Corn Products* principle should be applied to the sale of Section 1231 assets. By declaring in its opinion that petitioners did not acquire an interest in the timber, the lower court avoided this issue. We submit that the issue was fairly presented to the Court of Claims panel and should have been resolved by it.

CONCLUSION

We submit that this Court should review this case because the *Corn Products* principle has been applied in this and countless other cases by the lower courts

during the past twenty years in various and conflicting ways and has been extended far beyond the originally intended scope of this principle. As the Court of Claims itself declared in its 1975 decision in *Agway, Inc. v. United States*, 524 F.2d 1194:

> "*Corn Products* has been applied in lower courts in a variety of situations which possibly might surprise the *Corn Products* court."

Before the decision of the Court of Claims in the instant case, however, no court had ever applied the *Corn Products* principle to a single sale, whether or not in the final liquidation of a taxpayer's business.

It is also submitted that this Court should hear this case to declare whether or not the *Corn Products* principle should be extended to the sale of depreciable property or real property used in the trade or business of the taxpayer, as

those terms are defined in Section 1231 of the Internal Revenue Code. Despite agreement by petitioners (in the alternative) and respondent in the briefs filed in the Court of Claims that the sale of a Section 1231 asset was involved here, the Court of Claims held to the contrary, thus avoiding this issue. On three prior occasions* the Court of Claims declined to apply the *Corn Products* principle to the sale of Section 1231 assets. There is an extended discussion of the reasons why the *Corn Products* principle should not be applied to the sale of Section 1231 assets in *Deltide Fishing & Rental Tools, Inc. v.*

E. I. du Pont de Nemours Company v. United States, (1961) 153 Ct. Cl. 274, 288 F.2d 904

Philadelphia Quartz Company v. United States, (1967) 179 Ct. Cl. 191, 374 F.2d 512

Grant Oil Tool Co. v. United States, (1967) 180 Ct. Cl. 620, 381 F.2d 389

United States, (D.C. La. 1968) 279 F.Supp. 661. On the other hand, the Court of Appeals for the Ninth Circuit held on one occasion that it could apply. *Hollywood Baseball Association v. Commissioner*, (1970) 423 F.2d 494.

This apparent conflict should be resolved by this Court.

It is submitted that a clarification by this Court of the extent of the application of the *Corn Products* principle would be beneficial to these and other taxpayers and even to the Internal Revenue Service itself.

For these reasons, it is respectfully submitted that this Petition for a Writ of Certiorari should be granted.

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In the United States Court of Claims

No. 31-75

(Decided March 23, 1977)

EMMETT E. NORTON and FRANCES G. NORTON v. THE UNITED STATES

Charles P. Duffy, attorney of record, for plaintiff. *Duffy, Stout, Georgeson & Dahl*, of counsel.

C. Patrick Derdenger, with whom was *Acting Assistant Attorney General Myron C. Baum*, for defendant. *Theodore D. Peyser*, of counsel.

Before DAVIS, KASHIWA and KUNZIG, *Judges*.

ON PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT AND DEFENDANT'S CROSS MOTION FOR SUMMARY JUDGMENT

KASHIWA, *Judge*, delivered the opinion of the court:

This tax refund action involving the characterization of gain realized by plaintiffs from their sale of a timber cutting contract is before the court on cross motions for summary judgment. The facts essential to the disposition of the case are not in dispute. For the reasons set forth below, we agree with the defendant that the gain realized by the plaintiffs does not qualify as gain from the sale of a capital asset. We, therefore, allow defendant's cross motion for summary judgment.

Plaintiff,[1] Emmett E. Norton, an individual doing business as the Norton Logging Company, on January 30, 1968, entered into a timber cutting contract[2] with the United States Forest Service (hereinafter referred to as the Turn Point contract). The Turn Point contract specified:

> In consideration of the premises and the promises hereinafter contained, Forest Service agrees to sell and permit Purchaser to cut and Purchaser agrees to purchase and cut included Timber.

All right, title and interest in and to any included timber in the Turn Point contract remained in the Forest Service until it had been cut, scaled and paid for; at that time, title vested in the plaintiff who then had to remove the processed timber from the contract sales area within the period of the contract. All losses, except for negligence, were to be borne by the party holding title.

Throughout the remainder of 1968 and until March 19, 1969, plaintiff was engaged in the logging business. This entailed both the cutting of the standing timber located in the South Tongass National Forest subject to the Turn Point contract and the selling of the logs to Ketchikan Pulp Company (hereinafter referred to as Ketchikan), an unrelated Washington corporation. The plaintiff did not operate a sawmill nor was he engaged in manufacturing lumber, veneer or other wood products. His sole activity was the cutting of the standing timber and its sale to Ketchikan.

As the standing timber was cut and scaled, the plaintiff was required to pay the Forest Service under the terms of the contract $9.05 per thousand board feet for Sitka Spruce and $2.32 per thousand board feet for Western Hemlock and other species. To insure the performance of his obligation under the Turn Point contract, the plaintiff executed a performance bond in the amount of $5,000.

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[1] Frances G. Norton is a party to this action only because she filed joint returns with her husband, Emmett E. Norton, for the years in question. Where reference is made to Mr. Norton acting individually, he will be referred to as the "plaintiff"; where reference is made to both Mr. and Mrs. Norton, they will be referred to as the "plaintiffs."

[2] United States Department of Agriculture Forest Service Timber Sale Contract No. 05-92. The contract relates to certain designated timber in the South Tongass National Forest, State of Alaska.

During the period January 30, 1968, through March 19, 1969, the plaintiff logged 9,919,040 board feet of the estimated 30,000,000 board feet of timber subject to the contract.

On March 19, 1969, 13½ months after the plaintiff entered into the Turn Point contract, he sold all of the timber cutting rights under the contract to Ketchikan for the sum of $127,500,[3] with no interest thereon, payable at the rate of $8.50 per thousand board feet of logs produced. In connection with the transaction, Ketchikan executed a promissory note which recites that Ketchikan will pay the plaintiff the $127,500, regardless of an over-run or under-run of the volume of timber under the Turn Point contract.[4]

Prior to the March 19, 1969, sale to Ketchikan, the plaintiff had neither sold nor held for sale a Government timber contract. After that sale, the plaintiff ceased independent logging operations entirely and sold all logging equipment, machinery and supplies to Ketchikan.

In filing their joint federal income tax return for the year 1969, the plaintiffs elected to report the gain realized from the sale of the timber cutting rights to Ketchikan on the installment basis pursuant to § 453.[5] Their tax basis for determining gain or loss was $7,400,[6] with a resulting 94.2 percent of gain. On their income tax returns for the years 1969, 1970 and 1971, the plaintiffs reported 94.2 percent of the amount received from Ketchikan as long-term capital gains.

Upon audit of plaintiffs' tax returns, the Commissioner of the Internal Revenue Service (Commissioner) deter-

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[3] Even though the bill of sale specified that both the Turn Point contract and various pieces of logging equipment were sold for $127,500, the Norton affidavit makes it clear that the $127,500 was the purchase price of the timber cutting rights alone.

[4] Since the total purchase price was not dependent upon the amount of timber cut, plaintiff concedes that he did not retain an economic interest in the timber transferred to Ketchikan within the meaning of I.R.C. § 631(b). Therefore, I.R.C. § 1231(b)(2) is not applicable to the instant case.

[5] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954.

[6] Plaintiffs' tax basis is the sum of a $5,000 cash bond and a $2,400 advance stumpage deposit with the Forest Service.

mined that the gain recognized by plaintiffs in 1969, 1970 and 1971, attributable to the sale of the Turn Point contract to Ketchikan, should have been reported as ordinary income rather than as long-term capital gain. A statutory notice of deficiency for 1969 through 1971 was issued by the Commissioner on March 20, 1973. Thereafter, plaintiffs received billings for the deficiency, which they were unable to pay within 10 days because of lack of funds.

On November 21, 1973, the plaintiffs paid $8,000 to the District Director, Anchorage, Alaska. On January 21, 1974, the Division of Veterans Affairs of the Department of Commerce of the State of Alaska paid, on the plaintiffs' behalf, the remaining sum of $10,999.48 from the proceeds of a loan.[7]

Plaintiffs filed with the Internal Revenue Service (IRS) Center at Ogden, Utah, their timely refund claims for the years 1969 through 1971. The IRS not having acted upon their refund claims for more than 6 months after the date of filing, the plaintiffs filed a petition in this court based upon the same grounds as set forth in the refund claims.

Plaintiffs argue that the timber cutting contract involved herein was a capital asset, or in the alternative, plaintiff's interest in the contract and underlying timber was "real property used in the trade or business" of plaintiff within the meaning of § 1231(b)(1). Under either alternative, plaintiffs contend that the gain realized on the sale of the contract qualifies as long-term capital gain since the contract was held by plaintiff for more than six months. Nevertheless, plaintiffs concede that a portion of the payments received by them on the sale of the Turn Point contract should be imputed interest, taxable as ordinary income.[8] Lastly, plaintiffs seek refund of the additions to the tax, "late-payment penalties," which they argue should

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[7] Payments totaling $18,999.48 were received by the Internal Revenue Service; $5,468.81 was allocated to plaintiffs' 1969 tax year; $6,290.58 was allocated to plaintiffs' 1970 tax year; and $7,240.09 was allocated to plaintiffs' 1971 tax year.

[8] I.R.C. § 483; Treas. Reg. § 1.483-1(c)(2), T.D. 6873, 1966-1 C.B. 101. In the case of an installment contract which does not contain any provision for interest, the amount of interest to be imputed is computed at the rate of 5 percent per annum compounded semiannually. Although not applicable to the instant case, it should be noted that T.D. 6873 was amended by T.D. 7394, 1976-1 C.B. 135.

not have been exacted from them since their failure to pay the deficiencies within ten days of the date of the first notice and demand therefor was due to reasonable cause—inability to pay or undue hardship—and not due to willful neglect within the purview of § 6651(a)(3).

On the other hand, defendant contends that the gain realized by plaintiffs from the sale of the Turn Point contract does not qualify for capital gain treatment. Initially, the defendant submits that plaintiff's interest in the Turn Point contract and the underlying timber was real property used in plaintiff's trade or business; it must be treated as a noncapital asset by virtue of § 1221(2), but is precluded from § 1231(a) treatment by the *Corn Products*[9] doctrine since the contract was an integral part of the plaintiff's business. Alternatively, defendant argues that the *Corn Products* doctrine would exclude plaintiff's contract from § 1221. Defendant has failed, however, to address the plaintiffs' last contention that their failure to pay the deficiencies within ten days of the date of the first notice and demand therefor was due to reasonable cause.

We are faced with the preliminary issue of whether plaintiff's interest in the Turn Point contract would qualify either as a § 1221 asset or as a § 1231(b)(1) asset, but for the *Corn Products* doctrine. Of necessity, we then must examine the *Corn Products* doctrine to determine its applicability to the instant case.

Defendant contends and the plaintiffs submit as an alternative argument that plaintiff's interest in the Turn Point contract and underlying timber was real property used in the plaintiff's trade or business. We find these contentions lack merit. To constitute realty plaintiff must have acquired a present interest in the standing timber on the execution of the contract. The facts before us do not demonstrate that the parties to the contract intended to transfer a present interest in the standing timber. As we earlier recapitulated, the contract gave plaintiff the right to purchase and cut timber; however, until cut and paid for, the title to that timber remained in the seller. This

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[9] *Corn Products Refining Co. v. Comm'r*, 350 U. S. 46 (1955).

indicates an intent that no present interest in real property, the standing timber, passed to the plaintiff. We have considered our decision in *Barclay* v. *United States*,[10] in addition to *United States* v. *Giustina*,[11] which decisions, while interpreting similar timber cutting sales contracts with relation to the word "owner" in § 117(k)(2) of the 1939 Code [now § 631(b) of the 1954 Code], held that such contracts gave the holder beneficial ownership of all the timber on the tract.[12] To the defendant, the fact that plaintiff had beneficial ownership in the timber is sufficient to make the timber cutting contract real property. Defendant reasons that standing timber is real property; therefore, a timber cutting contract which gives beneficial ownership in standing timber is real property. With this reasoning we cannot agree. The above cases define owner status for § 117(k)(2) of the 1939 Code purposes; they do not determine that the timber contract there in issue is real property. In fact, this court in *Barclay*[13] refused to consider whether the timber contract there in issue qualified for § 117(a) of the 1939 Code [now §§ 1221 and 1222 of the 1954 Code] which thereby obviated the need to determine whether the contract was real property used in the taxpayer's trade or business. Since we are convinced that on the facts before us the parties did not intend to transfer a present interest in the standing timber, we hold that plaintiff's interest in the Turn Point contract was not real property used in his trade or business. It should be noted that our decision is compatible with the Tax Court's decision in *J. R. Simplot Co.* v. *Commissioner*,[14] which held that a similar contract was insufficient to transfer a present interest in the standing timber.

To disqualify the Turn Point contract from § 1231(b)(1), we must also determine that it was not "property used in the trade or business of a character which is subject to the

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[10] 166 Ct. Cl. 421, 333 F. 2d 847 (1964). *See also Union Bag-Camp Paper Corp.*, 163 Ct. Cl. 525, 325 F. 2d 730 (1963).

[11] 313 F. 2d 710 (9th Cir. 1962).

[12] *See also* Treas. Reg. § 1.631-2(e)(2) (1960) and Rev. Rul. 58-295, 1958-1 C.B. 249.

[13] 166 Ct. Cl. at 427, 333 F. 2d at 851.

[14] 26 T.C.M. (CCH) 488 (1967).

allowance for depreciation provided in section 167." Given the nature of the contract, this task is not difficult. The Turn Point contract was merely a sales contract obligating the plaintiff to purchase a specific amount of timber—whether cut or not—within a period of approximately three years.[15] Nonetheless, the contract was not the type asset which diminished in value with use or passage of time and it had neither a basis nor a useful life; consequently, it was not of a character subject to the allowance for depreciation. We, therefore, hold that the Turn Point contract was not property used in the plaintiff's trade or business within the definition of § 1231(b)(1). However, we do not agree with the plaintiffs who submit that the contract is a § 1221 asset.

The plaintiffs argue that they sold the Turn Point contract, itself, rather than the timber which was the subject of that contract. They assert that the contract was "property" which did not fall into any of the specified exclusions of § 1221 and, therefore, the contract is a capital asset, the sale of which gave rise to capital gain. The plaintiffs also rely upon *Commissioner* v. *Ferrer*,[16] for the proposition that a contract is a capital asset if the contract rights created an equitable interest in specific property which was itself a capital asset. By arguing that the contract gave plaintiff an equitable interest in the timber subject to the contract, citing *Barclay* v. *United States*, *supra*, the plaintiffs reason that they sold a capital asset. We disagree.

With respect to the treatment of amounts received on the sale of contract rights, courts have approached in numerous ways the question of whether the property disposed of was the type of property that Congress intended to classify as a capital asset.[17] Plaintiffs point to the approach

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[15] The contract was awarded on January 30, 1968, and was to terminate on December 31, 1970.

[16] 304 F. 2d 125 (2d Cir. 1962).

[17] Eustice, *Contract Rights, Capital Gain, and Assignment of Income—the Ferrer Case*, 20 Tax L. Rev. 1 (1964). The approaches may be grouped into certain broad categories: (1) Is the asset "property" which is a "capital asset" under § 1221? *See Comm'r* v. *Gillette Motor Transport Co.*, 364 U. S. 130 (1960); *Comm'r* v. *Ferrer*, *supra* note 16. (2) Do the amounts received by the taxpayer upon the sale of the contract

utilized in *Ferrer* to support their argument. In *Ferrer*, Judge Friendly summarized the immense body of decisional law in the assignment of income area and wrestled with the various complex issues that can arise from the basic question of whether a taxpayer has transferred a "property" right or an "income" right. Rather than utilize this approach, we feel that the instant case can be decided under the *Corn Products* doctrine exception to the statutory syllogism that all property is a capital asset unless specifically excluded by the exceptions in § 1221.

The Supreme Court has stated that the sale of property, though not literally within the exceptions of § 1221, may nevertheless give rise to ordinary income or loss when the asset is an integral part of the taxpayer's business. *Corn Products Refining Co.* v. *Commissioner, supra* note 9. The application of the *Corn Products* doctrine to the instant case seems clear to us. The plaintiff was engaged in the logging business: cutting standing timber and selling the cut timber to Ketchikan. The Turn Point contract gave the plaintiff the right to cut timber; it insured the plaintiff a ready source of supply of the logging business raw material, timber. The contract, therefore, was essential to and an integral part of plaintiff's logging business. The contract gave plaintiff rights in the timber which were so integrally related to his ordinary business objectives of logging the timber that a "business use" intention rather than an "investment" intent prevailed.[18] In other words, the contract was acquired by plaintiff with an intention that it would serve an integral function in his regular business activities and that motive had not changed at the time of sale. Under the *Corn Products* doctrine, gain on the sale of that contract is, therefore, part of plaintiff's

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rights represent a substitute for future ordinary income that would otherwise have been received by the taxpayer? *See Comm'r* v. *P. G. Lake Inc.*, 356 U. S. 260 (1958); *Comm'r* v. *Ferrer, supra*. (3) Does the transaction constitute a "sale or exchange"? *See Fairbanks* v. *United States*, 306 U. S. 436 (1939). (4) Was the property acquired with an intention that it would serve an integral function in the taxpayer's regular business activities? *See Corn Products Refining Co.* v. *Comm'r, supra* note 9.

[18] However, it should be noted that our approach here does not serve to read out of the statute the obvious and important class of "business connected" assets covered by § 1231.

ordinary business income. We are not persuaded otherwise by plaintiffs' argument that since the sale of the Turn Point contract represents the concluding phase of liquidating the logging business, the *Corn Products* doctrine should not be applied.[19]

Since we hold that the gain realized by the plaintiffs from the sale of the Turn Point contract was ordinary income within the rationale of the *Corn Products* doctrine, we need not consider the applicability of § 483 to the instant case.[20] However, we must address plaintiffs' argument that the additions to the tax, as provided under § 6651(a)(3), should not have been exacted from them. Plaintiffs argue that their failure to pay the deficiencies within ten days of the date of the first notice and demand therefor was due to their inability to pay which to them was reasonable cause, not willful neglect.

Reasonable cause for failure to pay tax exists to the extent the taxpayer can satisfactorily show that he exercised ordinary business care and prudence in providing for the payment of his liability, but was, nevertheless, either unable to pay the tax or would have suffered "undue hardship"[21] if he paid on the due date.[22] The burden of proving that the failure to pay was due to reasonable cause and not to willful neglect is on the taxpayer. If the taxpayer offers no excuse, the penalty will be sustained by the court.[23]

In the instant case, plaintiffs have failed to introduce any evidence to show that their failure to pay the tax was due to reasonable cause. We must, therefore, sustain the § 6651(a)(3) addition to the tax.

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[19] *See J. R. Simplot Co.* v. *Comm'r*, 26 T.C.M. (CCH) at 492. *Cf. Hollywood Baseball Ass'n* v. *Comm'r*, 423 F. 2d 494, 499–500 (9th Cir.), *cert. denied*, 400 U. S. 848 (1970) (*Corn Products* doctrine applied to § 337).

[20] I.R.C. § 483(f)(3).

[21] Undue hardship has the same meaning for § 6651(a)(3) purposes as it does under § 6161, extensions of time to pay tax, Treas. Reg. § 1.6161-1(b) (1960).

[22] Treas. Reg. § 301.6651-1(c)(1), T.D. 7133, 1971-2 C.B. 415.

[23] *Deffendall* v. *United States*, 386 F. Supp. 509, 512 (D. Or. 1974); *Fischer* v. *Comm'r*, 50 T.C. 164, 177 (1968). *Cf. Olshausen* v. *Comm'r*, 273 F. 2d 23 (9th Cir. 1959), *cert. denied*, 363 U. S. 820 (1960) (I.R.C. § 294 of the 1939 Code, burden to prove reasonable cause on the taxpayer).

CONCLUSION

For the reasons hereinbefore stated, plaintiffs' motion for summary judgment is denied, defendant's cross motion for summary judgment is granted and plaintiffs' petition is dismissed.

IN THE UNITED STATES COURT OF CLAIMS

No. 31-75

EMMETT E. NORTON and
FRANCES G. NORTON

v.

THE UNITED STATES

Before DAVIS, Judge, Presiding,
KASHIWA and KUNZIG, Judges.

ORDER

This case comes before the court on plaintiffs' motion, filed April 4, 1977, for rehearing en banc pursuant to Rules 7(d) and 151(b). Upon consideration thereof, together with the response in opposition thereto, without oral argument, by the six active Judges of the court as to the suggestion for rehearing en banc under Rule 7(d), which suggestion is denied, and further having been so considered by the panel listed above as to the motion for rehearing under Rule 151(b),

IT IS ORDERED that plaintiffs' said motion for rehearing, filed April 4, 1977, be and the same is denied.

BY THE COURT

/s/ Oscar H. Davis

Oscar H. Davis
Judge, Presiding

APPENDIX C

APPLICABLE SECTIONS OF THE INTERNAL REVENUE CODE OF 1954

"Sec. 1221. For purposes of this subtitle, the term 'capital asset' means property held by the taxpayer (whether or not connected with his trade or business), but does not include--

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or real property used in his trade or business;

(3) a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by--

(A) a taxpayer whose personal efforts created such property,

(B) in the case of a letter, memorandum, or similar property, a taxpayer for whom such property was prepared or produced, or

(C) a taxpayer in whose hands the basis of such property is determined, for purposes of determining gain from a sale or exchange, in whole or part by reference to the basis of such property in the hands of a taxpayer described in subparagraph (A) or (B);

(4) accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1); or

(5) an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue."

"Sec. 1231. (a) GENERAL RULE.--If, during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held

for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. . . .

(b) DEFINITION OF PROPERTY USED IN THE TRADE OR BUSINESS.--For purposes of this section--

(1) GENERAL RULE.--The term 'property used in the trade or business' means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not--

(A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year,

(B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or

(C) a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by a taxpayer described in paragraph (3) of section 1221.

(2) TIMBER, COAL, OR DOMESTIC IRON ORE.--Such term includes timber, coal, and iron ore with respect to which section 631 applies."